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INFLATION

MESSAGE

FROM

THE PRESIDENT OF THE UNITED STATES

TRANSMITTING

PROPOSALS FOR MEASURES FOR CURBING INFLATION AND PRESERVING OUR NATIONAL ECONOMY

September 8, 1966.—Referred to the Committee on Ways and Means and ordered to be printed

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To the Congress of the United States:

It is now time to set forth to the Congress and the American people the additional steps we consider necessary to assure the continuing health and strength of our economy.

I have been watching carefully the performance of our economy. I have consulted frequently and at great length with the wisest and most experienced advisers available to the President—with the responsible officials in my administration, with Members of the Congress, with leaders of business and labor, and with economists from our universities.

Prudent economic policy requires timely well-considered action in the national interest. The true interest of the American people lies in uninterrupted growth at stable prices. We must always be prepared to act to protect that growth. But we must act with caution and avoid drastic changes that are not clearly required for the economic welfare. We must focus our restraint on those sectors of the economy that need urgent attention.

Certain actions have become clearly necessary to protect the interest of our people in stable prosperity and I intend to take those actions now.

I am going to cut all Federal expenditures to the fullest extent consistent with the well-being of our people.

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I recommend that the Congress promptly make inoperative, for a temporary period, those special incentives for plant and equipment investment and commercial construction that currently contribute to overheating the economy.

Every effort will be made to ease the inequitable burden of high interest rates and tight money.

Further longer range actions may prove necessary to maintain balanced growth and finance the defense of Vietnam. But we will not have the necessary facts about fiscal 1967 expenditures until the Congress completes action on the remaining eight appropriation bills, and until the Department of Defense knows the size of the supplemental appropriations needed to support our men in Vietnam.

As soon as I receive these bills and defense estimates, I will again review Federal expenditures for this fiscal year. We intend to reduce or eliminate every possible Federal expenditure provided in those bills consistent with the well-being of our citizens.

When the Congress votes for add-ons to the remaining eight appropriation bills, it must bear in mind that each vote to increase the budget will likely require a vote to increase the revenue later.

This administration is prepared to recommend whatever action is necessary to maintain the stable growth and prosperity of the past 5½ years and to pay for current expenditures out of current revenues, as we are now doing.

The Performance of Our Economy

Today the strength of the American economy exceeds all records and all expectations. For 67 months—for 5½ years—the trend of our economy has been steadily up:

True production of goods and services has grown 5½ percent a year, putting the American economy in the front rank among the major nations of the world.

The spendable income of our consumers has increased 41 percent.

Nine million more workers are employed on nonfarm payrolls.

Unemployment has dropped from 7 to 3.9 percent.

No nation has ever enjoyed such prosperity.

High production, high wages, high profits, and low unemployment are benefits to be sought and preserved. The new problems of prosperity are much to be preferred to the old problems of recession or depression. But the great satisfaction that accompanies the solution of old problems must be tempered by full recognition of the new problems these solutions bring.

We must meet these new problems without jeopardizing past gains or present performance. And we must not revert to the pendulum economy of the 1950's.

Caution signs became visible early this year. Responsible fiscal policy required prudent action.

This administration and the Congress acted to protect our prosperity by taking $10 billion of excess purchasing power out of the economy this calendar year:

$6 billion through increased payroll taxes for social security and medicare.

$1 billion through restored excise taxes.

$1 billion through graduated withholding of individual taxes.

$1 billion through a speedup in corporate taxpayments.

$1 billion through an administrative acceleration of taxpayments.

Responsible fiscal policy also demanded tight control of Federal expenditures. This control has been exerted.

The fiscal 1966 budget on a national income basis—the best measure of the economic impact of Federal activity—showed an overall surplus of about $1 billion. In the first half of calendar 1966, the annual rate of this surplus rose to $3 billion. Since January 1 of this year, we have taken in more money than we have spent.

The fiscal 1967 budget submitted to the Congress reflects the same tight control. As a result, apart from special Vietnam costs, the 1967 budget increased expenditures by only $600 million—an increase of less than 1 percent over fiscal 1966. For the Great Society program enacted by the Congress, I requested an additional $3.2 billion—but only after offsetting reductions had been made—

By pruning lower priority programs;

By improved management and cost reduction; and

By closing obsolete bases and eliminating unnecessary defense expenditures.

Therefore, except for the $600 million, every dollar spent on Great Society programs was secured by reducing or eliminating outmoded programs.

In recent weeks, there have been signs of developing imbalance in the economy.

As we all know, prices have been rising. To be sure, average income is rising faster than prices, and average price increases in the past 5½ years are considerably less than in the previous 5½ years.

Nevertheless, sustained price increases in food, services, and industrial products threaten our delicately balanced structure of wage and price stability. We ask workers to restrict their wage demands to the gains in labor's productivity. But this also requires a reasonable prospect of stable living costs.

Ours is increasingly a fixed-income population. More than 20 million Americans depend on social security benefits. Millions of others live on modest private pensions, past savings, and the proceeds of life insurance policies.

Inflation imposes a cruel and unjust tax on all the people.

Inflation also saps the competitive strength of American industry in world trade. Recently, we have witnessed a decline in the trade surplus so vital to our balance-of-payments position. A healthy export expansion has not been enough to offset the bulging increase in imports.

In recent months, there has been an exaggerated boom in business investment. Moreover, the rapid growth of business credit has not moderated significantly, despite tight money restraints that, if intensified, threaten to halt balanced growth.

In the early 1960's, when there was unnecessary slack in the economy, and when growth was too slow, we took the steps needed to stimulate expansion and move toward full employment. But good economic policy works both ways. When total spending rises more rapidly than the economy can accommodate, when business investment creates undue pressures, when armed conflict overseas imposes new burdens on government, then we must be willing to shift into lower gear and reduce inflationary pressures.

Our program early this year to remove $10 billion from the U.S. economy was a first step in this direction. But the continued and mounting pressures since that time require the second-step program I am recommending today. And I shall not hesitate to take further fiscal steps when the size of the budget and the developments in our economy indicate that they are necessary.

Program of Action

I propose the following program of immediate action for the Congress and the American people:

1. *I am taking strong measures to reduce lower priority Federal expenditures.*

Determination of the exact amount of reduction in that limited portion of the fiscal 1967 budget under direct Presidential control must await congressional action on the remaining appropriation bills. Our best present estimate is that a reduction of 10 percent—approximately $3 billion—will be required from that portion of the budget.

Bills already passed by both Houses of Congress—some unanimously and others by large bipartisan majorities—have added approximately $2¼ billion to the spending authority I requested from this session of the Congress. If bills passed by one or the other of the Houses of Congress, or now before congressional committees, are finally approved in their present form, they will add almost $4 billion to Federal spending authority and $2 billion to spending in the current fiscal year. Members of the Congress will, by holding remaining appropriations within the amount of my requests, limit the amount of additional revenue that may be required next year.

Although the costs of the Vietnam conflict are uncertain, if this conflict extends beyond the current fiscal year, we will be forced to order additional material and equipment. To be on the safe side and to support our men in Vietnam, we must act on this contingency.

I have already directed that lower priority Federal programs be reduced by $1.5 billion in fiscal 1967.

Federal civilian agencies have been directed to defer, stretch out, and otherwise reduce contracts, new orders, and commitments. Each major agency has been given a savings target, with orders to meet that target.

I am prepared to defer and reduce Federal expenditures—

By requesting appropriations for Federal programs at levels below those now being authorized by the Congress;

By withholding appropriations provided above my budget recommendations whenever possible; and

By cutting spending in other areas which have significant fiscal impact in 1967.

My 1967 budget called for total expenditures of $112.8 billion. Of this amount, $58.3 billion is for defense. Of the remaining $54.5 billion, payments fixed by law or otherwise uncontrollable—such as civilian pay, interest on the public debt, veterans' compensation and pensions, public assistance payments, agricultural price supports, and payments on prior contracts—account for $31.5 billion. This leaves only some $23 billion of expenditures subject to immediate Presidential control.

The corresponding appropriation total (new obligational authority) is $31 billion. The savings I have directed must come from that total. They will not be easy to achieve.

But at a time when individual incomes and corporate profits are at unparalleled levels, a compassionate and mature people will not make the poor carry the burden of fighting inflation. For such a policy would be neither good economics nor social justice.

During the calendar year 1967, the product of the American economy will increase by some $50 billion. Before the end of this year, we will be producing at a rate of $750 billion—three-fourths of a trillion dollars—a year. And the Federal budget has been claiming a declining share of that product. The Federal administrative budget—the best measure of the size of Federal programs that are not self-financed—has declined from 17 percent of the gross national product in fiscal 1955 to less than 15 percent in fiscal 1966. If we had spent the same percentage as in 1955, our administrative budget would have been $15 billion higher last year.

I intend to conserve and save public outlays at every possible point. But it would be shortsighted to abandon the tasks of educating our children, providing for their health, rebuilding the decaying cities in which they live, and otherwise promoting the general welfare.

Postponed investment in buildings and machines can be made at a later date without serious injury. But we can never recapture the early years of a child who did not get the head start he needed to be a productive citizen, or the lost opportunities of the teenage dropout who was never given a second chance. And we can never repair the ravages of a disease that could have been prevented, or recall the lives lost by cancer that might have been cured.

The fiscal measures which have given us the unparalleled prosperity of the past 5½ years were a product of the partnership of the Congress and the Executive. The Great Society programs, placed on the statute books of this country by the overwhelming majority of the Congress, also reflect our partnership to promote the welfare of the people of this country. So, now, we must work together to assure that the prosperity and social progress of the past 5½ years continue.

2. *I recommend that the Congress make the 7-percent investment tax credit inoperative, effective September 1, 1966, to become operative again on January 1, 1968.*

The temporary suspension should apply to all orders for machinery and equipment placed on or after September 1, 1966, and before January 1, 1968, regardless of the date of their delivery.

The suspension should be across the board, without exception, applying effectively and equitable to all investing industries. No special treatment or special exclusions should be made for this brief period of suspension.

One of the great accomplishments of recent years has been the mighty upsurge of business investment in plant and equipment, to expand and update our industrial capacity and to provide more jobs for our workers. This gratifying surge is now, however, proceeding too swiftly. For the past 3 years, this investment has been rising more than twice as fast as our gross national product.

Our machinery and equipment industries cannot digest the demands currently thrust upon them. We see symptoms of strain in growing backlogs, accelerating prices, and emerging shortages of skilled workers.

There is a 10-month average backlog on machine tool orders alone. On many machine tools, the order backlog exceeds 15 months.

Our capital markets are clogged with excessive demands for funds to finance investment. These demands bid interest rates higher and higher, and draw too large a share of credit from other important uses.

The current machinery and equipment boom reflects many incentives and supports—the reform of depreciation guidelines, the investment tax credit, reductions in corporate income tax rates, the dramatic strengthening of consumer markets, and the stepped-up flow of defense orders.

I am asking Congress today to make inoperative for 16 months one of the special incentives in order to moderate the growth of capital spending.

Our high-employment, high-profit economy will still provide abundant incentive for growth in our capacity sufficient to produce the goods we need, for modernizing facilities, and hence for maintaining a strong international competitive position.

A temporary suspension of the investment credit will relieve excessive pressures on our capital goods producers and on our financial markets. We can then look forward to a smoother flow of investment goods—at stable costs both for machinery and for money.

The special credit was recommended as a bonus for investment to help move the economy forward. This recommendation reflected the commitment of this administration to a high-investment, high-research, high-growth economy. This is a firm, long-term plan that we intend to carry out. A high level of business investment is indispensable to our prosperity and to our economic growth. The bonus of the investment credit has proved itself to be too effective a promoter of such investment to be abandoned. We shall need this bonus over the years ahead and it should be restored.

Now, however, our problem is to keep investment within safe speed limits. We should not continue to press on the accelerator. We should not now provide a bonus to do something that we do not want done now and will very much want and need to be done later on.

3. *I recommend that the Congress suspend until January 1, 1968, the use of accelerated depreciation on all buildings and structures started or transferred on or after September 1, 1966.*

Just as machinery and equipment outlays are stimulated by the investment tax credit, construction of commercial and industrial buildings is advanced and encouraged by accelerated depreciation. To assure that safe speed limits are applied to all forms of investment, we should now remove this special incentive.

Today, it is contributing unnecessarily to an inflation of building costs and to the pressures on financial markets, which are reflected in high interest rates. In the past 12 months, commercial and industrial construction was 27 percent higher than during the previous year.

In the last few months, certain areas of private building have been caught in the vise of tight money and high interest rates. The suspension of accelerated depreciation is surely a more effective and equitable way to hold construction within bounds.

The logic and equity of restraint thus require suspension of accelerated depreciation. In this way, we can apply restrictive measures evenly to the various types of investment and through a broad and balanced use of our tools of economic policy.

4. *I urge the Federal Reserve Board, in executing its policy of monetary restraint, and our large commercial banks to cooperate with the President and the Congress to lower interest rates and to ease the inequitable burden of tight money.*

The Secretary of the Treasury has reviewed all potential Federal security sales and is taking action to keep them at the minimum in the months ahead. This should help reduce current pressures on the money market and on interest rates.

I urge the Congress to act promptly on pending legislation to prevent competition for deposit and share accounts from driving up interest rates.

As more of the burden of restraint is assumed by fiscal measures—by elimination of special stimulants to business investment, higher taxes, and reduced or postponed Federal spending—we should take further action to reduce the burdens imposed on the American people by tight money and high interest rates. Present monetary measures impose a special hardship on home buyers and small businessmen.

Banks should handle money and credit equitably and without extracting excessive profits. They should rely less on high interest rates to price borrowers out of the market and more on the placing of appropriate ceilings on credit.

I am responding to the requests of the financial community to ease the great pressure on money markets. The Federal Reserve Board and our large commercial banks must now recognize that we are determined to restrain inflationary pressures by fiscal and budgetary measures. I ask, in turn, that the financial community seize the earliest opportunity to lower interest rates and more fairly allocate the existing supplies of credit.

I have been assured that every effort is being made to detect any easing of inflationary pressures in order that monetary policy can be adjusted quickly and adequately to maintain stable and sustainable economic growth.

Preserving Economic Freedom

The demand for goods, including capital investment, must be kept roughly in balance with the ability of our economy to meet this demand. Within this general strategy for a free economy, we seek the cooperation of employers and unions in maintaining price and wage policies consistent with stability.

We ask that wage increases remain within labor's productivity gains. We ask that industry forgo price increases where there are no increases in costs and reduce prices when costs fall.

The alternative to this strategy is the endless pursuit of wages by prices, and prices by wages, to the common disadvantage of all participants and the Nation as a whole.

I ask American business to—

Base demands for credit on genuine needs, not on speculation of future scarcity or higher cost.

Maintain an inventory position based on current requirements, not on fears or hopes that prices will be higher later on.

Postpone investment projects that are not absolutely necessary at this time.

Set prices on the basis of real costs, not imaginary future costs that build in an assumption of inflation.

Limit profits to those appropriate for a steadily expanding economy.

I ask American labor to—

Avoid wage demands that would raise the average level of costs and prices in the economy.

Adopt work rules and standards for entry into its trades that are appropriate for a continuing full-employment economy.

Cooperate with business to raise productivity so that pay increases will be matched by production increases.

The steps I have taken and recommended today are needed to keep the American economy on the safe course of stable prosperity it has enjoyed for the past 5½ years.

Decisions made elsewhere will influence our defense needs in Vietnam. Because we cannot control or predict these outcomes, we cannot blueprint our fiscal measures in the months ahead. But should additional fiscal measures be required to preserve price stability and maintain sound fiscal policies, I will recommend them.

By continuing on a prudent course in our private and public policies and by preserving our capacity for stable economic growth, we can look forward to continuing progress. We can make that progress within the framework of a free economy. We do not want to resort to controls. If we take the necessary actions, next year should bring new heights in consumer living standards, in savings for the future, in our progress toward the Great Society.

I urge the Congress to exercise prudent restraint in appropriating public funds and to act promptly on the legislative proposals I have set forth in this message.

LYNDON B. JOHNSON.

THE WHITE HOUSE, *September 8, 1966.*

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